

Automatic Subordination Clauses

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Most Leases contain what are called automatic subordination clauses, pursuant to which the Tenant agrees that the Lease is subordinate to any Mortgages granted by the Landlord, whether they are already in existence when the Lease is signed, or granted by the Landlord in the future.

Such a clause can be made more complex by including other provisions, such as an agreement by the Landlord that the Tenant's subordination of the Lease is conditioned upon the Landlord's Lender, as Mortgage-holder, agreeing not to foreclose on the Tenant and thereby disturb the Tenant's possession as long as the Tenant is not in default of the Lease (typically called a non-disturbance clause). Another variation is to include a provision by which the Tenant agrees to recognize the Lender as the new Landlord if it forecloses the Mortgage and becomes the owner of the leased premises (typically called an attornment clause).

Some subordination clauses require, as a condition to their effectiveness, that the Lender and the Tenant enter into a Subordination, Non-Disturbance and Attornment Agreement (SNDA) addressing these matters. Other articles on this blog discuss what the parties to an SNDA typically want it to include, but rest assured that if you are a Landlord arranging for Mortgage financing, you can expect the negotiation of an SNDA between your Tenant and your prospective Lender to take to time and cost you money. Not only does the Landlord have to pay its own attorney to facilitate the negotiation and execution of an SNDA, but it also will have to pay the Lender's attorney's fees at the loan closing. To make matters worse, if you are dealing with a regional or national Tenant, it will likely have a legal department with attendant bureaucracy to muddle through in order to get an SNDA approved, which can take weeks if not longer.

The goal of this process is to get the Lender comfortable that the Lease will be subordinate to its Mortgage on terms that it can accept. This is usually evidenced by the Lender's attorney approving the subordination clause or SNDA (if applicable), as well as the Lender's title insurer agreeing to list the Lease as a subordinate matter in the Lender's title insurance policy which insures the lien of the Mortgage.

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It is almost instinctive for Lenders to request an SNDA from the Tenant whether the Lease requires one or not. Given the time and money it takes to put one in place, it is in the Landlord's interest to avoid this unless absolutely necessary (i.e., mandated by the Lease). An automatic subordination clause in a Lease can be self-operative, and relied upon without an SNDA if the Lease doesn't require one. Many title insurers will agree to insure the Lease as subordinate in a Lender's title insurance policy solely in reliance on an automatic subordination clause in the Lease. All you have to do is make the request and show the title insurer's underwriting counsel the Lease provision. If the automatic subordination clause truly is clear and unconditional, most title insurers will approve it and insure that the Lease is subordinate to the Mortgage without an SNDA.

Of course, it may be difficult when a Landlord's attorney initially negotiates a Lease to get the Tenant to agree to an automatic subordination clause without a lot of conditions (like the future negotiation of an SNDA), but it is worth the attempt. You are more likely to be successful in that effort with a Tenant that is a small business, as opposed to a regional or national business, so your starting point when preparing a Lease should always be a simple automatic subordination clause, without the extra complication of requiring an SNDA.